

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
N.A.C. Industries Corp. :
Formerly National American Corp. : AFFIDAVIT OF MAILING
:
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Corporation :
Franchise Tax under Article 9A of the Tax Law for :
the Fiscal Years Ended 11/30/77 - 11/30/80. :
:

State of New York :

ss.:

County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 7th day of November, 1985, he served the within notice of Decision by certified mail upon N.A.C. Industries Corp., Formerly National American Corp., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

N.A.C. Industries Corp.
Formerly National American Corp.
c/o Sommer, Abraham & Co.
424 Madison Avenue
New York, NY 10017

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
7th day of November, 1985.

David Parchuck

Bernice P. Haglund
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

November 7, 1985

N.A.C. Industries Corp.
Formerly National American Corp.
c/o Sommer, Abraham & Co.
424 Madison Avenue
New York, NY 10017

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Stuart Miller
Sommer, Abraham & Co.
424 Madison Avenue
New York, NY 10017
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
N.A.C. INDUSTRIES CORP.	:	DECISION
(formerly National American Corp.)	:	
for Redetermination of a Deficiency or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Fiscal Years :	:	
Ended November 30, 1977 through November 30,	:	
1980.	:	

Petitioner, N.A.C. Industries Corp. (formerly National American Corp.), c/o Sommer, Abraham & Co., 424 Madison Avenue, New York, New York 10017, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended November 30, 1977 through November 30, 1980 (File No. 46172).

A formal hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on February 28, 1985 at 1:45 P.M., with all briefs to be submitted by June 3, 1985. Petitioner appeared by Sommer, Abraham & Co., (Melvin Myerson and Stuart Miller, CPAs), and by Meshel & Silvert, Esqs. (Milton Meshel, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUE

Whether the Audit Division properly determined petitioner's tax liability on subsidiary capital.

FINDINGS OF FACT

1. Petitioner, N.A.C. Industries Corp. (formerly National American Corp.), timely filed New York State corporation franchise tax reports for each of its fiscal years ended November 30, 1977 through November 30, 1980.

2. On the various dates specified hereinafter, the Audit Division issued notices of deficiency to petitioner asserting additional tax due, plus interest accrued to the date of issuance, as follows:

<u>DATE OF NOTICE</u>	<u>NOTICE NO.</u>	<u>F/Y/E</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
8/17/81	C810817951N	11/30/77	\$4,042.00	\$1,206.78	\$5,248.78
6/24/83	C830624295N	11/30/77	2,214.00	1,479.62	3,693.62
6/24/83	C830624296N	11/30/78	2,507.00	1,462.33	3,969.33
6/24/83	C830624297N	11/30/79	2,137.00	1,064.87	3,201.87
6/24/83	C830624298N	11/30/80	515.00	212.85	727.85

3. Notice number C830624295N, dated June 24, 1983 and pertaining to the fiscal year ended November 30, 1977, supplants and represents a revision and reduction of notice number C810817951N, which was an estimated deficiency for the fiscal year ended November 30, 1977, previously issued on August 17, 1981. Furthermore, notice number C830624297N, pertaining to the fiscal year ended November 30, 1979 and issued on June 24, 1983, has been withdrawn by the Audit Division as untimely. Accordingly, remaining at issue are the deficiencies issued on June 24, 1983, pertaining to the fiscal years ended November 30, 1977 and November 30, 1978 (for which consents extending the period of limitation were executed) and the fiscal year ended November 30, 1980.

4. Petitioner was incorporated in the State of Delaware in 1968 and began doing business in New York State in the same year. Petitioner lists its principal business activity as "pharmaceuticals."

5. The deficiencies at issue are based on the Audit Division's calculation of tax on petitioner's subsidiary capital for each of the fiscal years in question, with such calculation of subsidiary capital based on petitioner's investment in and advances to its wholly-owned subsidiaries Gynechemie Research Corp. ("Gynechemie") and E. J. Moore and Sons, Inc. ("Moore").

6. On its franchise tax reports for each of the years in question, petitioner valued subsidiary capital at zero. The Audit Division, by contrast, valued petitioner's subsidiary capital at petitioner's cost (investment) to acquire the two noted subsidiaries plus advances (loans) made by petitioner to the two subsidiaries. At the hearing, the Audit Division noted that since the subsidiaries have deficit equity accounts and since their stock is essentially worthless, the valuation of subsidiary capital should be based on zero plus advances. Such valuation of investment at zero would result in a decrease in the asserted deficiencies, with tax on subsidiary capital thus based on (average) advances to the subsidiaries.

7. Petitioner maintains that there was never money available to make advances to Gynechemie in the amounts of such advances as reflected on petitioner's books and tax returns. Rather, petitioner asserts, the advances represent, in large part, bookkeeping changes whereby the original valuation of petitioner's investment in Gynechemie (as such valuation was determined in or about 1971 when petitioner obtained Gynechemie¹), was later reclassified so that the investment account reflected a low number while the advances account reflected a high number. Petitioner thus asserts that the advances account is really in

1 Gynechemie was acquired by the issuance of petitioner's (then National American Corp.) stock to Gynechemie's stockholders in exchange for Gynechemie's stock.

large measure its original investment in Gynechemie which, given Gynemchemie's accumulated losses, should be written down to zero as worthless. Petitioner notes that it operated and treated its subsidiaries in essence as part of one business and "not too much attention" was paid as to what amounts were shown as investment and what amounts were shown as advances.

8. Petitioner offered no evidence as to when the alleged accounting reclassification between the investment and advances accounts was made, nor any reason as to why such a reclassification would have been made. No firm amounts were stated as to the actual amounts loaned by petitioner to Gynechemie, although petitioner would "concede to a couple of hundred thousand dollars", but "...we are not talking about millions of dollars (advanced)."

9. Petitioner also asserts that the only significant asset ever owned by Gynechemie, a research and development company, was the rights to a contraceptive device called Semicid. In May of 1981, Gynechemie (and petitioner) sold the rights to Semicid, pursuant to a previously executed contract, receiving in return a net amount of \$996,491.00. Petitioner notes that the book value of Semicid, in view of the net amount ultimately received on sale, had been overstated during the years at issue. Accordingly, notwithstanding amortization of a portion of such book value over the years in question, petitioner maintains that the value of Semicid should be adjusted in each year based on the difference between Semicid's unamortized book (carrying) value in each year and the net amount ultimately received for Semicid. In turn, petitioner asserts that Gynechemie's true (average) fair market value should be the book value of its assets, including Semicid but at its reduced value, less Gynechemie's total debt except for intercompany (Gynechemie to petitioner) debt per books. Petitioner maintains, in conjunction with its previous assertion that loans in

the amounts shown per books were never actually made to Gynechemie, that the resultant fair market values are truer measures of petitioner's subsidiary capital during the years in question.

10. No evidence was offered concerning the Audit Division's computation of subsidiary capital with regard to petitioner's other subsidiary at issue, namely Moore.

CONCLUSIONS OF LAW

A. That, in addition to the tax measured by entire net income or other alternative basis, section 210.1(b) of the Tax Law imposes a tax measured by subsidiary capital. Section 208.4 of the Tax Law defines "subsidiary capital" as follows:

"The term 'subsidiary capital' means investments in the stock of subsidiaries and any indebtedness from subsidiaries, exclusive of accounts receivable acquired in the ordinary course of trade or business for services rendered or for sales of property held primarily for sale to customers, whether or not evidenced by written instrument, on which interest is not claimed and deducted by the subsidiary for purposes of taxation under articles nine-a, nine-b, nine-c, thirty-two or thirty-three of this chapter, provided, however, that, in the discretion of the tax commission, there shall be deducted from subsidiary capital any liabilities payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, which are attributable to subsidiary capital;...".

B. That 20 NYCRR 3-6.4 provides for the computation of subsidiary capital as follows:

"The amount of subsidiary capital of the taxpayer (parent) is determined by computing the average fair market value during the period covered by the report of all the assets of the taxpayer which constitute subsidiary capital, less certain liabilities required to be deducted (see: section 3-6.3 of this Subpart). Average fair market value is determined in the manner which is described in section 3-4.6 of this Part. In no event may a subsidiary be valued at less than 'zero'."

C. That 20 NYCRR 3-6.3 provides, in relevant part, as follows:

"[t]he term subsidiary capital means the total of:

- (1) the investment of the taxpayer in shares of stock of subsidiaries, and
- (2) the amount of indebtedness owed to the taxpayers by its subsidiaries, whether or not evidenced by written instrument, on which interest is not claimed and deducted by the subsidiary for purposes of any tax imposed by Article 9-A, 32 or 33 of the Tax Law. Subsidiary capital does not include accounts receivable acquired in the ordinary course of trade or business..."

D. That throughout the years in question petitioner carried intercompany advances as receivables (assets) on its books, and its subsidiaries carried such advances as liabilities. With respect to Gynechemie, while admitting that some advances were made, petitioner could neither specify more than generally the amounts of the advances admittedly made nor could petitioner specify the date of or reason for the alleged reclassification of a part of its investment in Gynechemie from investment to advances. Furthermore, no evidence was presented with respect to Moore. Finally, assuming arguendo that the advances per books represent for the most part merely a bookkeeping reclassification, there is no evidence of any attempt to claim such amounts carried as advances (assets) as bad debts, either for accounting or tax purposes. Petitioner may not now, in the face of the instant deficiencies, claim such assets as worthless. Having chosen to arrange its books in the noted fashion, petitioner must accept the tax consequences thereof. The Audit Division, therefore, properly included the advances at their average value as asserted by petitioner in its books and records in the computation of subsidiary capital for purposes of section 208.9(b)(6) and 210.1(b) of the Tax Law (see Matter of U.S. Summit Corporation, State Tax Comm., May 23, 1985).

E. That the petition of N.A.C. Industries Corp. (formerly National American Corp.) is denied and the notices of deficiency, as recomputed and

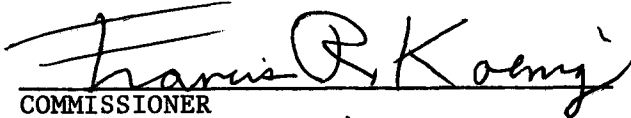
reduced to take cognizance of Finding of Fact "6" (computation of subsidiary capital based on zero plus advances), are sustained.

DATED: Albany, New York

STATE TAX COMMISSION

NOV 07 1985


PRESIDENT


COMMISSIONER


COMMISSIONER